

# Living Trusts

## What is a living trust?

A *living trust* is a trust that is funded with assets and that can be amended and revoked by the person creating the trust. The person creating the trust, often called the *settlor* or the *grantor*, typically retains all the benefits to the property placed into the trust. The grantor can also be the trustee in Ohio, although the grantor's spouse or a trust company also often serves as trustee. The terms of a living trust are established in a written agreement signed by the grantor and the trustee. A living trust can be funded with bank accounts, stocks and bonds, a home and other assets. The terms of the living trust should provide for the disposition of the property in the trust both during the life and following the death of the grantor.

## What is the purpose of a living trust?

A living trust may have many purposes. A common goal is to avoid *probate*. Assets within a living trust generally will not be subject to the jurisdiction of the probate court, either while the grantor is living or following the grantor's death. Assets owned in individual name and not contractually payable on death generally will be subject to probate.

## What is probate?

When an Ohio resident dies owning probate property, a legal proceeding is begun (1) to determine the last valid will of the decedent, if any; (2) to determine the nature, extent and value of the decedent's assets; (3) to establish the valid debts of the decedent; and (4) to establish the method of distribution of the assets to the heirs or beneficiaries of the decedent after payment of applicable debts, taxes and expenses. This proceeding is known as *probate*. A more detailed explanation of the probate process is available in the publication, "What you should know about . . . Probate," published by the Ohio State Bar Association.

## Is use of a living trust the only way to avoid probate?

No. Assets that are owned jointly with others with rights of survivorship will pass upon death to the survivor by operation of law and will not be probate assets. However, care should be exercised before creating a joint account, particularly with someone other than a spouse, because the joint tenant will have rights in the joint property immediately on creation. Payable-on-death accounts and any assets that are contractually payable to beneficiaries, such as life insurance or pension benefits, also will avoid probate. Transfer-on-death registration for securities and motor vehicles, and transfer-on-death deeds for real estate also will avoid probate.

### **Will I save estate taxes with a living trust, compared with a will?**

No. It is a common misconception that estate tax savings can be achieved with a living trust, but not with a will. While use of a living trust will avoid probate proceedings, *avoiding probate does not mean avoiding estate taxes*. The assets in a living trust are part of a person's gross estate for estate tax purposes, just the same as probate assets. However, both the will and living trust, when properly written and with advice on the proper ownership of assets during lifetime, may include estate tax avoidance techniques that may save substantial tax dollars for the benefit of the family.

### **Will having a living trust avoid challenges by my beneficiaries or heirs?**

Disgruntled heirs or beneficiaries can challenge the validity of a living trust on legal grounds similar to those available for challenging a will. It may be alleged that a living trust is invalid because the grantor was incompetent at the time of establishing the trust or was unduly influenced by some person to establish the trust in a particular manner. Further, although the time period for challenging the validity of a will can be limited to three months, there is a longer time period (usually two years) under which the validity of a living trust may be challenged. The cost of defending the validity of a will, where the executor acts in good faith, is payable from the probate estate. Under Ohio law, the court determines whether similar expenses in defending the validity of a living trust would be borne by the trust assets or by the trustee personally.

### **What are the advantages of a living trust compared to probate?**

Compared to probate, there are many differences, but also some similarities in the manner in which property is administered in a living trust following the death of a grantor. Among the characteristics of administration of a living trust that a person may find desirable are:

*Privacy.* The terms of a living trust are contained in a private document, while the terms of a will, including beneficiary designations, become a matter of public record once the will has been filed with the probate court. In addition, other information filed with the court during the probate process, such as the inventory of assets and the written account of all receipts and disbursements of the estate, also become matters of public record. The administration of a living trust generally is not made public.

*Control.* The absence of any requirements to file a will or any other reports with a court increases the independence and control of the trustee, relative to an executor.

*Lower costs.* Some publications make extravagant claims about the extent of the costs of the probate process. The typical components of cost in the probate process are:

- court costs
- appraisal fees
- executors' commissions

- attorney fees

While court costs will vary with the activity in the estate, presently a typical cost range will be \$200-\$250. A living trust would not bear these costs.

Appraisal fees typically will be incurred in probate for real property, and may be incurred for other "hard to value" assets, such as expensive artwork or closely held corporations. These costs typically would not be required by a living trust. If, however, the decedent's assets are of such value that an estate tax return must be filed (which often will be the case), it will be necessary for the trustee of a living trust to secure appraisals of those assets to establish value for estate tax purposes. Appraisals also aid in establishing the basis of the assets for federal income tax purposes.

Executors' commissions are set by state law and are based, generally, on a percentage of the value of the assets of the estate. At present, the commission varies between one and four percent of the value of the assets (combined with the income on those assets) depending on the nature, amount and title of the assets at death. However, surviving spouses and other family members often serve as executor and may waive these commissions. A trustee of a living trust generally is entitled to a fee for services performed similar to those performed by an executor, although the level of compensation is not set by law.

An executor may hire an attorney to assist in the administration of a probate estate. Similarly, a trustee may hire an attorney to assist in the administration of a living trust following the death of the grantor. If the terms of the living trust do not require the preparation of an inventory or the preparation of accounts, as typically they do not, the attorney fees generally will be lower for services to the trustee because time related to probate filings will not be incurred. However, the cost of attorney advice and services with regard to income tax and estate tax issues is likely to be equivalent whether provided to the executor of a will or to a trustee.

*Speed of transfer.* A trustee could begin making distributions of assets to beneficiaries moments after the death of the grantor. An executor cannot make distributions until he or she is appointed by the court after the will is admitted to probate, but this appointment generally occurs within days after death and, once appointed, the executor is legally empowered to distribute all the probate assets to the beneficiaries. However, it is not necessarily prudent for either a trustee or an executor to immediately distribute assets.

An executor may be personally liable for the claims of creditors left unpaid by the estate as well as any unpaid federal and Ohio estate taxes. Consequently, the executor generally will not make final distribution to the beneficiaries until the executor is satisfied that all valid claims have been paid and all estate taxes have been finally determined and paid. The trustee of a living trust also may be held personally liable for unpaid estate taxes and, in some circumstances, unpaid creditors.

*Avoidance of multiple probate proceedings.* Finally, if homes or other real property are owned in a number of different states, use of a living trust may be especially useful to avoid separate probate proceedings in two or more states.

### **What are the disadvantages of a living trust compared to probate?**

*Lifetime effort.* The implementation of a living trust is likely to be more time consuming and far more tedious than would be the case with only a will. The single most common defect in the implementation of a living trust, where the goal is to avoid probate, is the failure to transfer ownership and title of assets into the name of the trustee. Simply creating the document will not work; the assets must be re-registered, re-titled or otherwise validly transferred to the trustee of the living trust. Further, an individual needs to remain vigilant that all assets acquired after creation of the living trust are placed into the living trust. Otherwise, those assets may pass through probate.

*Lifetime Costs.* While a living trust may have cost advantages relative to probate following death, a will generally has cost advantages relative to a living trust during an individual's lifetime. The costs associated with creating a living trust generally are more than those for creating a will. Also, the need for a will is not eliminated as it often is necessary to dispose of assets at death that may not have been transferred to the living trust during the grantor's lifetime. In addition, there are costs incurred in properly transferring assets to the living trust during lifetime. If the trustee is not the grantor or a member of the grantor's family, periodic trustee fees usually will be incurred if the living trust is funded.

*Absence of court review.* The administration of a living trust will not be supervised by any court. While this avoids the paperwork burden and expense imposed by the probate process, persons creating a living trust should consider that the trustee they appoint will not be accountable to a judge for the honest and accurate distribution of assets unless a beneficiary were to bring a lawsuit.

*Taxation disadvantages.* The Internal Revenue Code contains a number of income tax provisions that are more beneficial to estates than to living trusts operating after the death of the grantor. As examples, an estate is entitled to establish a fiscal year, whereas a trust must report on a calendar year. An estate is entitled to a personal tax exemption of \$600 for each tax year, whereas the living trust exemption is \$300 in the case of *simple trusts* and \$100 for *complex trusts*. Federal legislation allows a trust to be taxed like an estate if the trustee of a living trust elects to do so.

### **Will a living trust help me while I am living?**

A living trust may provide a structure for the management of a person's assets. This structure could be particularly useful if the trustee has investment expertise, such as a trust company, or the trustee retains investment counsel. The asset management function of a living trust can become particularly important if the grantor becomes incompetent or is otherwise incapable of handling financial affairs. If a living trust is in place, it is not

then necessary to have a guardian appointed by the probate court to administer the now incompetent grantor's assets. On the other hand, the execution of a *durable power of attorney*—a document by which an individual (the principal) gives another person (the attorney-in-fact) the power to manage the principal's assets—also avoids the necessity of a court guardianship.

### **Will a living trust save income taxes?**

No. The income of the living trust will be taxable to the grantor as if the trust did not exist for income tax purposes. In most cases, the income from the living trust may be reported under the grantor's Social Security number, and the trust need not obtain a separate taxpayer identification number nor file annual tax returns.

### **Will a living trust protect my assets against creditors?**

Creditors are entitled to reach the assets of a living trust during the grantor's lifetime. Even where the trust is irrevocable, if the transfer is made to that trust while there are unpaid creditors of the grantor, creditors generally can reach the assets of the trust. Creditors generally may reach the assets of any trust to the extent that the grantor can enforce his or her own rights to trust assets. Upon the death of the grantor, it is uncertain under Ohio law whether creditors of the grantor may enforce claims against a living trust, depending on the circumstances of creation and administration of the living trust. A surviving spouse may not have elective share (*forced inheritance*) rights against a living trust as would be available against probate assets.

### **Can I preserve assets in a living trust and still qualify for Medicaid?**

No. The assets in a living trust are *countable resources* for purposes of Medicaid qualification. The assets in the living trust are treated just the same as if they were owned by the grantor.

### **If I decide a living trust may be right for me, how should I set one up?**

If you decide that the use of a living trust may be right for you or if you are uncertain whether a living trust would be beneficial, it would be wise to consult with an attorney who is knowledgeable in probate, estate planning and tax matters. After obtaining information from you concerning the nature, title and value of your assets and liabilities, and following discussions with you concerning your goals for the use of your property during lifetime and following death, your attorney will be able to advise you in advance of the costs for consultation and, following the consultation, provide you with an estimate of legal and other expenses involved with the drafting and implementation of a living trust. The drafting of a living trust, like most other legal documents, requires professional judgment if the best results are to be ensured. A lawyer can help you avoid the pitfalls and help you choose the legal instruments and plan best suited for your situation.